

2004 Strategic Financial Plan – Introduction

Orange County continues its commitment to long-range financial planning with the following 2004 Strategic Financial Plan (SFP). The SFP results in the identification of financial priorities, forecasts revenues and expenses, and develops a balanced five-year financial outlook. Fiscal Year (FY) 04-05 is the County's seventh published. This summary will provide some of the SFP highlights presented to the Board of Supervisors on May 7, 2004, as well as updated information since its adoption on June 29, 2004.

During the May 7th presentation the following topics were covered: Economic and Revenue forecasts; Preliminary Fiscal Year 04-05 General Fund Budget; State Budget impacts on the County General Fund; 2004 Strategic Priorities; 2004 Strategic Financial Plan and Balancing Scenarios. The introduction, however, will focus on the County's involvement in the State Budget, 2004 Strategic Priorities, and 2004 SFP and Balancing Scenarios.

Strategic Financial Plan

As an important component of the SFP, the A. Gary Anderson Center for Economic Research at Chapman University provides various forecasts and assumptions. Chapman University prepares a number of items that the County utilizes in the SFP including an Economic, Revenue, Consumer Price Index, Public Safety Sales Tax and Realignment Revenue Forecasts. With this information, the County builds forecasts for most of its funds (focusing on Net County Cost), identifies Strategic Priorities, estimates revenue projections, Fund Balance Available (FBA) or carryover and departmental expenditures.

While every effort is made to include all timely, relevant information in the SFP, unforeseen circumstances sometimes occur. At the time the 2004 SFP was being prepared, the following information was not complete or available:

- Impact of State Budget revenue shift from the General Fund
- Potential "swaps" of Vehicle License fees or Sales Tax for Property Taxes
- Potential need for additional retiree medical costs
- Bankruptcy debt reductionPotential loss of 10% of Public Safety Sales Tax revenue to the Fire Authority should the March 2006 ballot initiative pass

General Fund Budget

For FY 04-05, the County of Orange decided to combine the SFP and Budget processes into one and move toward a biennial budget. As a result, the first year of the SFP is also the Preliminary 04-05 Budget. For FY 04-05, the total County budget is \$4.6 billion, which includes approximately \$543 million (roughly 12% of the Budget) in the discretionary General Fund, the portion of the budget the Board of Supervisors has significant decision-making authority over. General Purpose Revenues are comprised of the following sources (updated figures provided in brackets):

(\$ in millions)

- | | |
|--|---|
| - Property Tax – \$202.5 [\$202.4] | - Sales Tax – \$8.2 [\$8.3] |
| - Vehicle License Fees – \$173.4 [\$145.6] | - Interest – \$6.2 [\$6.2] |
| - FBA – \$107.2 [\$145.2] | - Miscellaneous Revenue – \$12.7 [\$13.9] |
| - Operating Transfers – \$13.7 [\$14.6] | - Other – \$18.2 [\$11.1] |

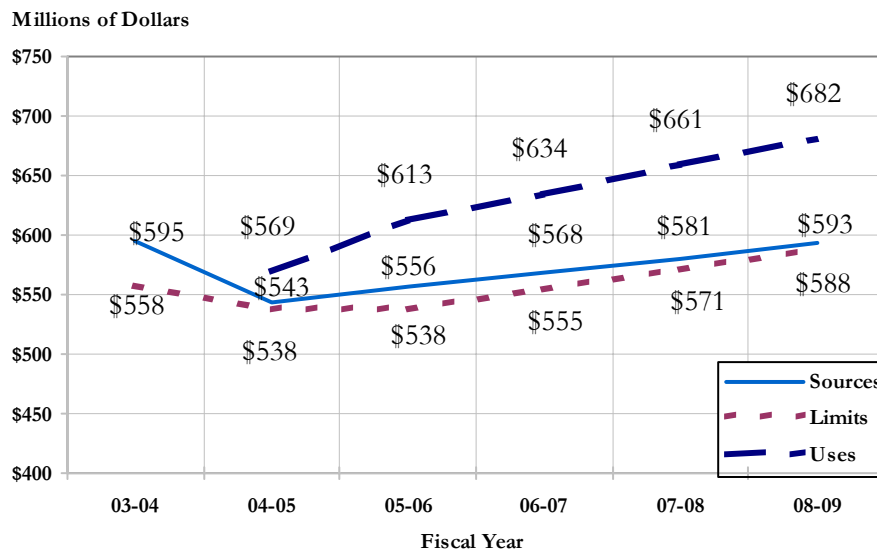
These revenues are dedicated to fund services in the County’s seven program areas as General Fund Net County Cost (NCC) (updated NCC figures provided in brackets):

(\$ in millions)

- Program I – Public Protection, \$255.2 [\$261.2]
- Program II – Community Services, \$136.3 [\$137.7]
- Program III – Environmental and Infrastructure Resources, \$36.3 [\$36.7]
- Program IV – General Government Services, \$71.9 [\$72.3]
- Program V – Capital Improvements, \$32.9
- Program VI – Debt Services, \$2.8
- Program VII – Miscellaneous, Reserves, and ISFs, \$6.7 [(\$0.7)]

The SFP’s five-year projections indicate that expenditures will increase much faster than revenues. To prepare for the latter years of the SFP, the County has undertaken a process to control future spending levels. The first two years of the 2004 SFP call for level spending, and allow for modest increases in the remaining years. In addition, the County has in place a Resource Management plan, which outlines various types of savings measures, depending on the level of reductions needed to control costs. In FY 03-04, the County implemented Step 2 reductions of the plan. Step 2 reductions of the plan, which included the implementation of a freeze on hiring and leave balance payoffs. These reductions resulted from a review of all County functions with the focusing resources on core County activities vs. non-core, mandated vs. non-mandated programs, and programs requiring matching County funds vs. programs receiving overmatching funds.

2004 Strategic Financial Plan
Sources vs. Uses
(As Adopted June 29, 2004)



For FY 04-05, the County set a total Net County Cost limit of \$534.7 million [approved NCC limit increased to \$543 million] for all departments (see above figure). To meet their assigned NCC, some departments were required to make cuts to their FY 04-05 budgets. Subsequently, departments requested an additional \$48 million in restoration and expansion augmentations, above the \$534.7 million NCC limit, to maintain or expand current levels of services. However, given the lack of County resources and the State's budget crisis, the County was able to fund only \$8.2 million of these requests, leaving departments with the option to absorb, cut or eliminate existing programs or services to finance these requests. The majority of the funding requests, more than 70%, are in Program I – Public Protection and Program II – Community Services. Faced with rising expenditures and lower projected revenues, the County has planned for the following consequences for FY 04-05:

- Closure of two Youth & Family Resource Centers.
- Youth Leadership Academy operational costs will be absorbed by the Probation Department but will require reductions in other areas.
- Reduction of mental health services for indigents.
- Reduction in Alcohol and Drug treatment centers.
- Reduction in Family Health clinic services.
- Reduction in programs targeted to assist senior citizens.
- Reduction to County funds for the Human Relations Commission.

State Budget Impacts

At the time the SFP was prepared, the State of California was drafting a preliminary budget. Included in the State's budget were spending reductions impacting the County. Anticipated State losses total \$42.1 million, including In-Home Support Services (IHSS) and Temporary Assistance to Needy Families (TANF) funds [Funding for both programs have since been restored as a result of the State-approved budget]. Other issues that could affect the County in regard to the State budget are:

- Shift of General Fund revenue of \$28 million per year for two years, not currently reflected in FY 04-05 Budget [This shift will occur as part of the 2004-05 State-approved budget. Funding for this shift will be paid from the County reserves.]Unreimbursed Mandates (SB90) - \$76 million owed to the County
- Underfunded Substance Abuse and Crime Prevention Act (Proposition 36)
- Continued Funding of Flood Control Subvention Claims for Santa Ana River Project
- Realignment Revenue – growth not keeping pace with Social Services, Health and Probation programs

Strategic Priorities

Although the majority of the SFP deals with day-to-day operations, the County also looks at major projects, known as Strategic Priorities. Such undertakings are usually long-term, more than \$1 million in scope and can range from new facilities and programs to major technological improvements. With this review, these programmatic and infrastructure related projects are included in the SFP process.

County department heads and staff held an offsite meeting to prioritize this year's list of 43 requested Strategic Priorities and make recommendations to the Board of Supervisors. While

most were previously identified, departments did introduce new ones. The following is the Top 10 list recommended to and approved by the Board.

- 1 CAPS Replacement
- 2 Credit and Debt Management Strategy
- 3a District Attorney High Tech Crime
- 3b Identity Theft
- 4 Bioterrorism
- 5 Affordable Housing
- 6 Los Pinos Wastewater Mitigation**
- 7 Youth and Family Resource Centers
- 8 Preventive Maintenance**
- 9 Water Quality and Watershed Protection
- 10 800 MHz CCCS Upgrade

** Included in 04-05 Recommended Budget

For a complete listing and description of all Strategic Priorities, please refer to the 2004 Strategic Priorities link on the County's website.

In addition the Top 10 list, five previously identified Strategic Priorities are funded in the FY 04-05 Budget and SFP at \$15.9 million. Almost all of the projects, which include the Central Justice Center remodel, Deferred Maintenance/ADA, CAPS Replacement, Juvenile Hall 60-Bed Expansion, Assessment Tax System, and Youth Leadership Academy, have funding for FY 05-06.

Balancing the Plan

The section looks at how the County will balance the 2004 SFP, amid the cuts, augmentation requests, and the lack of financial resources. For the County to continue operating within its means and provide services, the Budget and SFP must be balanced. Reaching this goal is more difficult with the probable shift of \$28 million to the State for a two-year period, beginning in FY 04-05. Expansion augmentation requests further exacerbate the balancing task. To close the projected gap, the Board of Supervisors was given five different scenarios to choose from.

- No. 1 – Use all reserves and debt reduction funds
- No. 2 – Use all reserves and no debt reduction funds
- No. 3 – Use all reserves except \$55 million; no debt reduction funds
- No. 4 – Use reserves, \$56 million, only for revenue shift to State; no debt reduction funds
- No. 5 – No reserve or debt reduction fund use at all

The following assumptions were common to all scenarios:

- Adds \$28 million per year for two years to the operating gap for revenue shift to State
- Does not fund Expansion Level of Service Augmentations

Staff recommended Scenario No. 4 for the Board's consideration. Here are the key points of the plan:

- Uses \$56 million from reserves to fund the State's two-year revenue shift from the County, leaving a \$209 million reserve balance
- Does not approve funding of Expansion Level of Service Augmentations
- Requires a \$35 million reduction in General Fund programs in FY 04-05, average \$16 million per year reductions in each of the following years
- Does not require use of funds set aside for debt reduction
- \$94 million in debt reduction funds remain available to reduce Net County Costs by \$5 million per year starting in FY 05-06

Summary/Next Steps

The SFP process continues to be a valuable planning tool for the County as it provides the framework for balancing available resources with operating requirements, implementing new programs and facilities. As a result, the Board is able to make annual funding decisions within a comprehensive long-term perspective. Since 1998, the SFP has been annually updated to review revenues and expense forecasts.

The next step is to prepare for the 2005 SFP. Preliminary work will begin when Chapman University updates its Economic and Revenue forecasts for Orange County in Fall 2004. County staff will begin work on the 2005 SFP upon approval of the FY 05-06 Budget in June 2005. The County has revised the order in which the SFP and Budget are prepared. For next year, the Budget will be completed before the SFP. The approved FY 05-06 Budget will be Year 1 of the 2005 SFP and used to estimate revenue and expenditures for the remaining four years of the SFP.